

BEFORE THE
ILLINOIS COMMERCE COMMISSION

Alhambra – Grantfork Telephone)
Company:) Docket No. 04-0354
)
Petition for Universal Service Support)

STAFF OF THE ILLINOIS COMMERCE COMMISSION'S
REPLY BRIEF

PUBLIC VERSION

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Or marked "Confidential"

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I. Summary of Argument

The Commission should deny AGTC's request for IUSF funding. The Commission should not consider AGTC's request, but, even if it does, the fact remains that AGTC has utterly failed to meet its burden of showing that it is entitled to funding.

The Commission offered specific guidance to AGTC in its *Fourth Interim Order*.¹ First, the Commission cautioned that “[n]othing requires the Commission to use the same generic criteria used in establishing the USF and eligibility for USF support when evaluating a[n] individual LEC request for addition subsidization.” Fourth Interim Order at 8. Second, it cautioned AGTC that “nothing in the Act or the Commission’s prior orders entitles each recipient LEC seeking additional USF support to a specified rate of return.” Id. Finally, the Commission stated: “AGTC bears the burden of establishing that additional USF support is appropriate”” Id.

AGTC appears to have ignored all of these cautions. It has failed to meet its burden of proof. Its case is little more than an assertion that it is not making its rate of return, and so should receive IUSF funding sufficient to make up the difference between what it contends it is earning, and 11.21%. Finally, it has ignored the Commission’s clear statement that the criteria for funding when the fund was established need not apply here.

¹ Fourth Interim Order, Illinois Independent Telephone Association: Petition for initiation of an investigation of the necessity of and the establishment of a Universal Service Support Fund in accordance with Section 13-301(d) of the Public Utilities Act / Illinois Commerce Commission On Its Own Motion: Investigation into the necessity of and, if appropriate, the establishment of a Universal Support Fund pursuant to Section 13-301(d) of the Public Utilities Act, ICC Docket Nos. 00-0233 / 00-0335 (Consolidated)(April 7, 2004) (hereafter “Fourth Interim Order”)

Moreover, AGTC is, rather obviously, seeking support for advanced services, which the IUSF specifically does not support. AGTC concedes that it undertook its outside plant upgrade at least “partially in response to the passage of 220 ILCS 5/13-517 (which requires all ILECS to provide advance [sic] services to 80% of their subscribers by January 1, 2005)[.]” AGTC IB at 10. Carefully note that AGTC’s rationale for its outside plant upgrade, the timing and configuration of which has been a source of considerable controversy in this proceeding, has shifted back and forth over time. However, AGTC itself clearly concedes that it made its outside plant investment at least partially to provide services that the IUSF does not support.

Accordingly, the Commission should deny AGTC’s request for funding. If it elects to consider AGTC’s request, it should require that AGTC amend its request for IUSF support to remove expenses and capital expenditures associated with advanced service deployment. In addition, the Commission should insist that AGTC’s amended IUSF request conform with mandated cost allocation methodologies for expenses and investments that are common to it and its non-regulated subsidiaries and that AGTC remove all subsidization of its non-regulated subsidiaries. Finally, the Commission should require AGTC to account fully for likely increases in federal USF payments and interstate access revenues in any amended bid for IUSF support.

II. AGTC's request for IUSF funding should be rejected

A. State and Federal policies underlying high cost support do not require that AGTC receive funding

AGTC contends that the purpose of universal service support has been to promote universally available telephone service at reasonable and affordable rates. AGTC IB at 2. AGTC argues that the purpose of the IUSF, like its federal counterpart, is to provide needed financial support to rural local exchange carriers, where the cost of service exceeds the revenue so those carriers can provide telephone service to rural customers that would otherwise be cost-prohibitive. AGTC IB at 4. AGTC further maintains that partially as a result of its normal investment cycle, and partially in response to the passage of Section 13-517 of the Public Utilities Act, 220 ILCS 5/13-517, it undertook a major upgrade of its outside plant facilities. AGTC IB at 10. AGTC then argues that it should receive IUSF funding for the upgrades it undertook. AGTC IB at 11-13. Finally, AGTC maintains that Staff is fundamentally and philosophically opposed to the very purpose and concept of universal service support for rural telephone companies and it is for this reason that Staff opposes AGTC's application for IUSF support.² AGTC IB at 15.

² In making these assertions, AGTC takes the liberty of quoting from *Romeo and Juliet*. AGTC IB at 16. Staff will reply in kind. Thus, when AGTC describes other parties to this proceeding as "contempt[uous]", and "hostil[e]", and accuses them of the use of "verbal gymnastic contortions" and "inflammatory language", AGCT IB at 15-16, as well as making "Draconian" recommendations that would be "horrible public policy", Id. at 17, Staff is compelled to recall Lord Macbeth's pointed observation that some statements are "full of sound and fury, signifying nothing." *Macbeth*, Act V, Scene 5. When AGTC then, in the *very next* paragraph, accuses the *same* parties of "demagog[uey]", AGCT IB at 15, it is difficult to refrain from

Contrary to AGTC's assertions, Staff fully supports the stated policy of the State of Illinois, which is to promote universally available telephone service at reasonable and affordable rates; Section 13-102 of the Public Utilities Act provides as much.³ 220 ILCS 5/13-102(a). However, this general policy cannot – as AGTC would wish – preempt the clear provisions of Section 13-301(d), which sets forth the detailed, specific way in which this general policy is to be implemented. Staff is obligated to seek enforcement of this provision and associated Commission Orders according to their tenor, which is fatal to AGTC's application.

AGTC's repeated citation to the Harrisonville case does not support its position in any way. AGTC appears to have concluded, and certainly advances the argument, that the Harrisonville decision, see Harrisonville Telephone Co. v. Commerce Comm'n, 212 Ill. 2d 237; 817 N.E.2d 479; 2004 Ill. Lexis 1020; 288 Ill. Dec. 121 (2004), supports the propositions that (a) the IUSF should support advanced services because the FCC is considering such a requirement; and (b) the Commission is required to march lockstep with the FCC in all matters related to high cost support. AGTC IB at 15, *et seq.*

observing that the company "doth protest too much, methinks." *Hamlet*, Act III, Scene 2. Indeed, AGTC might well be urged to: "pause, or be more temperate." *King John*, Act II, Scene 1.

³ However, it is important to remember that declarations of findings and intent, such as those contained in Section 13-102, are no more than prefatory, and without substantive or positive legal force. Monarch Gas Co. v. Commerce Comm'n, 261 Ill. App. 3d 94, 99; 633 N.E.2d 1260, 1264; 1994 Ill. App. LEXIS 513 at 10; 199 Ill. Dec. 269 (5th Dist. 1994), *app. den.*, 157 Ill. 2d 505, 642 N.E.2d 1284, 205 Ill. Dec. 167 (1994). AGTC's reliance upon such provisions is therefore questionable.

The *Harrisonville* decision will bear no such interpretation. It stands for nothing more than the proposition that Section 13-301(d) requires that all eligible lines receive support for all eligible (i.e., voice grade) services. Harrisonville, 212 Ill. 2d at 251; 817 N.E.2d at 488; 2004 Ill. Lexis 1020 at 23-25. Beyond that holding, the Harrisonville decision does not reach. No party to this proceeding suggests that AGTC should not get whatever support to which it might prove to be entitled for the purpose of supporting voice grade access to all access lines. The fact remains, however, that AGTC is not entitled to support, so this is of no relevance.

As an aside, the Supreme Court recognized, although AGTC significantly fails to note, that, in the *Universal Service Proceeding*, the Staff urged the Commission to support all lines; which scarcely comports with AGTC's assertion that Staff does not support universal service. See Harrisonville, 212 Ill. 2d at 240; 817 N.E.2d at 481-82; 2004 Ill. Lexis 1020 at 3-4 (Staff urged the Commission to support voice grade service for all lines).

Although Staff fully endorses the concept of providing financial assistance to small rural carriers that supply voice-grade services, Staff also believes that small rural carriers have an obligation to operate their systems as economically as possible to minimize the burden placed on subscribers statewide who pay surcharges that support the IUSF fund. Section 13-103(a) of the Public Utilities Act confirms this view, declaring the State policy for universal service to be as follows:

Telecommunications services should be available to all Illinois Citizens at just, reasonable and affordable rates and that such

services should be provided as widely and **efficiently** as possible in sufficient variety, quality, quantity and reliability to satisfy the public interest.

220 ILCS 5/13-103(a) (emphasis added)

The Commission recognized this, even if AGTC does not. In its *Second Interim Order*, the Commission aptly summarized the principles that guided it in establishing the IUSF:

[W]e have the obligation, consistent with principles of equity, to ascertain each funded company's actual need for support. Should we fail to do so, we would be compelling ratepayers of non-IITA companies to bear a greater burden than necessary to support the costs associated with serving their fellow citizens in areas served by IITA companies, a result we consider inequitable and unjust. Additionally, we must balance these considerations with our statutory responsibility for maintaining universally available service.

Second Interim Order at 37

In implementing these principles, the Commission noted that the small companies had much to answer for; instead of taking steps to solve their own financial affairs, they instead "chose[] to do nothing and simply rely upon ... continued subsidization[.]" Second Interim Order at 32.

The Commission made it clear that small companies could no longer expect – despite AGTC's fond hopes, as expressed in its *Petition* – ratepayers elsewhere to guarantee that small companies would receive a guaranteed rate of return (ROR) from the IUSF, but rather, were to look, as far as possible to their own operations to earn revenue, with the IUSF at hand to assist in this, based on each carrier's forward looking cost of providing supported services. Accordingly, before granting AGTC any IUSF funding, the Commission must first determine whether AGTC is conducting its operations as efficiently as possible thereby

minimizing the burden it places on other Illinois subscribers. There is no evidence that AGTC has responded to this Commission directive.

AGTC alleges that partially because of its investment cycle and partially in response to the passage of 220 ILCS 5/13-517, the company undertook a major upgrade of its facilities. AGTC IB at 10. AGTC asserts that the plant upgrade was necessitated in part by increased trouble reports. Id. However, the trouble report data provided by AGTC do not suggest that there was a marked, or indeed even significant, deterioration in service quality that would justify a major upgrade of AGTC's facilities. Staff IB at 28; Staff Ex. 1.0 at 15-18. In addition, as SBC witness James E. Stidham observes, AGTC could have chosen to upgrade its facilities over a greater number of years, which would have significantly reduced the short-term impact on Alhambra's earnings. SBC Ex. 1.0 at 11-18; SBC IB at 5. This is because there is a lag between the time at which a carrier experiences a change in its cost base (i.e. when the carrier invests in its network), and the time at which it begins to receive additional revenue (in the form of increased federal USF payments and interstate access revenues) associated with that additional cost. SBC Ex. 1.0 at 11-18; SBC IB at 6.

In 2001, AGTC sought IUSF support and was awarded a subsidy of \$0.32 per line per month. AGTC now seeks support of approximately \$7.00 per line per month. Staff Ex. 1.0 at 7; 3.0 at 10. It is unreasonable for AGTC to seek a 20-fold increase in its subsidy in just three years, especially where, as here, the subsidy appears likely to be used to support data services not covered by the IUSF. In contrast, Verizon, which operates many rural exchanges in Illinois, and which

receives no IUSF funding has managed its costs in such a way that it was recently able to provide \$25 million in rate cuts and rebates to its subscribers.

B. The Commission should adopt Staff's "compelling rationale" test

AGTC argues that Staff's compelling rationale test is "irrational". AGTC IB at 16. In particular, AGTC contends that Staff' proposed test is woefully deficient because it simply encourages a perpetuation of the *status quo* at the time of the *Second Interim Order*, without regard to changes to the individual circumstances of small companies, except in the most extreme cases created by chance. AGTC IB at 18. AGTC suggests that additional support would be dependent upon "the occurrence or non-occurrence of natural disasters". Id.

The Staff's "compelling rationale" test is, in fact, neither irrational, or, indeed, unprecedented. AGTC attempts to suggest that a tsunami, tornado, earthquake, or plague of locusts will have to strike Grantfork before AGTC is entitled to additional funding. See AGTC IB at 18 (referring to the alleged need for a "natural disaster" under Staff's test). This is simply not the case. Staff's proposed compelling rationale test consists of two elements. First, a small company must demonstrate that its rate of return is 3% below the target established in the IUSF Proceeding. Staff Ex. 3.0 at 3. Staff recommends a threshold of 3% to ensure that companies can only apply for more IUSF monies when there is a significant, as opposed to a trivial deterioration in their finances. Second, a company would have to demonstrate that the reduced rate of return is

due to circumstances beyond the company's control. Id. Circumstances beyond a company's control would include, but not necessarily be limited to, such events as: (a) a sudden increase or decrease in the number of lines served (5% since the *Second Interim Order on Rehearing*); (b) a sudden increase or decrease in total access minutes (20% since the *Second Interim Order on Rehearing*); (c) a sudden increase or decrease in input prices (interest rates and equipment prices but not wages); or (d) legislative requirements that impose additional costs. Id. In other words, contrary to AGTC's assertions, a number of non-Apocalyptic circumstances would permit a high cost company to apply for additional funding.

The Commission has, in the past, approved the use of a mechanism very much like the "compelling rational" test. In fact, the test is patterned upon the "Z" term in SBC's price cap formula. Under the alternative form of regulation that the Commission has adopted for SBC, SBC's non-competitive rates are indexed to general inflation in the economy minus a productivity or "X" factor. Currently the X factor is 4.3%, so if economy wide inflation is 2%, then the price cap formula would dictate that SBC reduce its non-competitive rates by 2.3% per year (2%-4.3%). In addition to this type of indexing, SBC's price cap formula contains a "Z" term, which allows SBC to pass through cost increases outside of management control onto ratepayers. See *Final Commission Order* at 102-103, Illinois Bell Telephone Company: Application for review of alternative regulation plan / Illinois Bell Telephone Company: Petition to Rebalance Illinois Bell Telephone Company's Carrier Access and Network Access Line Rates / Citizens Utility Board and the People of the State of Illinois -vs- Illinois Bell Telephone

Company: Verified Complaint for a Reduction in Illinois Bell Telephone Company's Rates and Other Relief, ICC Docket No. 98-0252/0335; 00-0764 (consol.) (December 30, 2002) (hereafter "Alt. Reg. Review Order") (Use of exogenous change factor, adopted in original *Alt. Reg. Order* extended in *Alt. Reg Review Order*). Exogenous changes consist of "only costs that are truly outside the company's control", and included changes in taxes, law, and costs associated with new regulatory requirements. *Final Commission Order* at 62, Illinois Bell Telephone Company: Petition to Regulate Rates and Charges of Noncompetitive Services Under an Alternative Form of Regulation, ICC Docket Nos. 92-0448/93-0239 (Consol.), October 11, 1994 (hereafter "Alt. Reg. Order"). So, for example, if the General Assembly passes legislation that causes SBC's costs to increase then SBC has a right under the "Z" factor in the price cap formula to pass these costs on to its subscribers in the form of increased rates if the increase in costs is significant.

The Staff's "compelling rationale" proposal is very similar to this "Z" factor, which, as noted above, the Commission found to be perfectly rational in the *Alt. Reg Order*. The compelling rationale test, like the Z factor, permits a company to seek relief when it is confronted with circumstances truly outside of its managerial control, such as regulatory requirements that impose new costs. Under the compelling rationale test AGTC is allowed more IUSF funding if: (a) costs increase due to factors outside of management's control; and (b) the increase in costs outside of management's control has a significant impact on the finances of AGTC. If costs *within* management's control increase – as the record

reflects is very clearly the case here – a company is not allowed increased IUSF funding, but can recoup its higher expenses by raising rates. It should be noted that AGTC will have the opportunity to apply for increased IUSF funding in 2006 for any acceptable reason when the IUSF fund comes up for renewal.

The “compelling rationale” test is in the public interest, since it will clearly spell out the circumstances under which small companies can apply for IUSF funding and the circumstances under which small companies cannot apply for increased IUSF support. Staff IB at 23. The compelling rationale test will afford management of small companies incentives to solve financial shortfalls through better administration, rather than through regulatory pleading.

Moreover, Staff’s proposal does not perpetuate the *status quo*; the Commission’s *Second Interim Order on Rehearing* does, setting a review date of 2006 for the IUSF. Staff merely articulates a principled basis by which the status quo can be reviewed with respect to individual carriers. It is AGTC that seeks extraordinary relief here.

C. AGTC’s costs do not justify IUSF support at the present time

AGTC contends that Section 13-301(d) requires that support for IUSF must be based on economic costs. AGTC IB at 12. While Section 13-301(d) does not define “economic costs”, AGTC presented evidence using the HAI model for ‘forward looking costs’ that suggests AGTC’s costs per line is \$104.35 per month per month, and that AGTC’s funding eligibility is between \$918,776 and \$409,897. AGTC Ex. 1.0 at 41. However, AGTC does not seek funding in the

amount of its forward looking cost, but instead requests funding based on ROR analysis which would require \$101,000 in subsidies. AGTC IB at 13. More specifically, AGTC appears to maintain that if economic cost per line is shown to be greater than revenue per line, and if ROR analysis indicates that ROR costs are lower than a possible estimate of economic costs, then AGTC should automatically be awarded the difference between its ROR costs and its revenue per line since it is asking for much less than economic costs developed by the HAI model would entitle it to. AGTC IB at 13.

Staff did not endorse the HAI model, the model inputs or the model results – this is because forward looking costs are very difficult to estimate and a proper examination of the HAI model and inputs would require more time and resources than either Staff, or indeed AGTC, was prepared to expend. Staff Ex. 1.0 at 21-22. Rather, Staff took a pragmatic approach to estimating “economic costs” and agreed that AGTC had made a *prima facie* case that “economic costs” per line are greater than revenues per line. Staff then contended that once “economic costs” per line are plausibly shown to be greater than revenues per line actual IUSF support should be based as the difference between historical cost and revenue if the Commission wants to consider IUSF funding for AGTC – which for reasons articulated in Staff’s *Initial Brief*, it should not.

Staff’s approach does not imply that it would accept any and all historical costs estimates alleged by AGTC. Staff is duty-bound to examine AGTC’s historical costs to determine which costs, in its opinion are valid, and which are not. This is what Staff has done, and, based in its analysis of AGTC’s costs and

revenues per line, Staff does not believe AGTC should be granted increased IUSF funding at this time. Staff IB at 12-13.

D. The Commission should apply the same set of rules to all IUSF eligible companies

According to AGTC, Staff urges the Commission to deny AGTC's application so that other small companies, whether worthy or not, will be deterred from applying for IUSF funding. ABTC IB at 34. AGTC further opines that it is unclear why the mere possibility of other applications is so "troubling" to Staff especially, since that possibility exists even if AGTC is denied support, and that therefore AGTC should not be denied funding simply because other companies may or may not apply. Id.

Staff agrees that AGTC should not be denied funding simply because other companies may or may not apply for increased IUSF support. This is not to suggest, however, that the Commission might not properly deny AGTC funding based on the timing of its *Petition*. Rather, AGTC should be denied funding because its case is utterly without merit. As the Commission observed in its *Fourth Interim Order*, it is under no obligation to guarantee small companies a specific rate of return by increasing IUSF surcharges every time a small company falls short financially, Fourth Interim Order at 8. This is especially true where, as here, the evidence demonstrates clearly that AGTC made investment decisions based on factors completely unrelated to provisioning supported voice-grade services.

Management of IUSF eligible companies should take the steps necessary to achieve desired financial targets and should be discouraged from continually asking for bigger subsidies. In the *Universal Service Fund Proceeding*, the Commission decided on the appropriate level of subsidy for AGTC and other small companies and no increase in this subsidy is warranted at this time. Staff Ex. 1.0 at 12.

If the Commission wishes to entertain AGTC's request for funding, it should, as Staff recommends, take this case as an opportunity to establish criteria that clearly define the circumstances under which small companies will in future be permitted to apply for increased IUSF funding, and the circumstances under which small companies cannot do so. In other words, the Commission should establish the "compelling rationale" test proposed by Staff. Staff Ex. 3.0 at 2-3.

If the Commission fails to establish a "compelling rationale" or similar test, small companies will apply for IUSF funding whenever they fall short financially. Staff Ex. 1.0 at 11. This will create funding inequities among companies since small companies whose funding needs have declined since the USF proceeding would not likely apply to have their funding reduced. Staff Ex. 1.0 at 11.

Finally, if the Commission allows small companies to file for increased IUSF support under *any* circumstances when they fall short financially, small companies will be tempted to "game" this policy. In particular, small companies will be tempted complete investment upgrades over shorter periods of time than they normally do. AGTC's *Petition* is an object lesson in such practices. See SBC

Ex. 1.0 at 12-13, 17-18. (AGTC's expedited upgrade resulted in worse apparent financial situation than actually existed). Similarly, small companies will be tempted to mass or "clump" discretionary operating expenses into the test year period in order to maximize their perceived financial shortfall at the time they apply for increased IUSF funding. Again, the evidence in this proceeding shows that AGTC has done precisely this. *Id.* If, under these circumstances, the Commission grants the small company the support it seeks, the small company will be certain to over-earn in subsequent years, since the IUSF support will be fixed but its capital expenditures, expenses and financial need will likely decline from the artificially elevated levels alleged in its IUSF filing.⁴ It is time-consuming for Commission Staff, and the Commission to examine a small company's accounts to determine whether this type of behavior is taking place. This is why the Commission should not have an open door IUSF funding policy.

E. AGTC can raise rates to address its alleged Financial Shortfall

AGTC contends that Staff first directly and indirectly argues for a higher affordable rate than \$20.39 established by the Commission. AGTC IB at 28. According to AGTC, the affordable rate should represent the maximum rate in rural areas. *Id.* at 28-29. ATGC further alleges that Staff is trying to indirectly raise the affordable rate by denying AGTC appropriate IUSF funding. *Id.* at 29.

⁴ AGTC takes exception to any policy that "exalts its financial status at the time of the IUSF Order above its current conditions", AGTC IB at 18, but appears to have no objection to "exalting" its alleged current conditions, over those that will exist in future years of high federal support and interstate revenues.

AGTC is completely wrong in these assertions, and demonstrates little more than a failure to understand the purpose of the affordable rate developed pursuant to Section 13-301(e)(4) of the Public Utilities Act, 220 ILCS 5/13-301(e)(4). The affordable rate of \$20.39 was never meant to represent the maximum rate to be charged in rural areas; instead, it was a tool to establish a proper IUSF fund size. See 220 ILCS 5/13-301(d)(Economic cost less federal subsidies less affordable rate equals funding per line). This is clearly evident from the Commission's *Second Interim Order*; there, the Commission set an affordable rate of almost \$25 for Leaf River and \$22.45 for Yates City. Staff Ex. 1.0 at 9, n.12. In other words, the affordable rate is not an upward limit on what rural subscribers should pay in rates; rather, it is intended to make certain that rural companies cannot maximize subsidies by reducing rates. This is, again, demonstrated by the statutory language, which provides that the affordable rate for any given company shall be "no less than the rates in effect at the time the Commission creates a[n IUSF] fund[.]" 220 ILCS 5/13-301(e)(4). The Commission recognized this when it noted that it could set an affordable rate at a level higher than small companies' then-existing rates. Second Interim Order at 32. Accordingly, AGTC's notion that the statute absolutely insulates it, under any circumstances, from having to even consider charging more than the affordable rate, is patently contrary to the law.

If rates as high as \$25 for Leaf River subscribers are affordable, then a rate at least as high as \$25 is affordable for AGTC subscribers, in the sense that AGTC subscribers can afford to pay them. The Commission should dismiss

AGTC's argument that any proposal suggesting that it should raise its rates constitutes an attack on the affordable rate.

AGTC appears to be under a continuing misapprehension regarding the state of high cost support in Illinois. AGTC's approach is: If the company fails to recover revenues from all other sources sufficient to give us our rate of return, it should be permitted make up the difference from intrastate high cost support. This appears to have been the manner in which things worked prior to the enactment of Section 13-301(d). However, in establishing the IUSF pursuant to Section 13-301(d), the Commission specifically rejected this "make whole" approach, noting that:

[T]he General Assembly did not intend that we merely continue to authorize, on a recurring and ongoing basis, the current scheme of intrastate high cost support, through which we blindly ratify the request of high cost companies to provide support at whatever level they believe that they need.

Second Interim Order at 37.

Moreover, the Commission noted elsewhere that the high cost companies had made virtually no effort to deal with their own cost issues, stating that:

Rather than rebalancing rates and working to ensure that access prices recovered costs, the IITA members have chosen to do nothing and simply rely upon the continued subsidization provided by the DEM Weighting Fund and the Illinois High Cost Fund. Other Illinois ratepayers should not be subjected to excessive surcharges because the IITA members have elected to not actively reduce their dependence on subsidies.

Second Interim Order at 32

The Commission elected to reject a small-company proposal that did not "create an equitable balance between the interests of the IITA members'

subscribers, who benefit from a subsidy, and other subscribers, who pay the subsidy.” *Id.* at 33.

It is clear that the Commission expected high cost companies to engage in a certain amount of self-help, rather than rely on subsidies. AGTC appears to disagree with the Commission on this point; its approach is based on maximizing subsidies, precisely contrary to what the General Assembly and Commission intended.

This should not be permitted to continue; AGTC should be provided the proper incentives to operate its telephone operations as efficiently as possible. If AGTC can be confident that the IUSF will make whole any financial shortfall the company experiences then AGTC management will not have much incentive to operate efficiently. On the other hand, If AGTC management (and management of other small companies) is convinced that any financial shortfall the company experiences will have to be made up (at least to some extent) by increasing rates, then AGTC will have much greater incentives to manage as efficiently as possible.

F. AGTC should employ mandated cost allocation methodologies before submitting any bid for increased IUSF support

In its *Initial Brief*, AGTC asserts that:

AGTC has specifically taken steps to reduce the cost of the telephone company by using current telephone company employees to support and service other enterprises and to directly assign the costs of those employees to those enterprises, reducing the costs of running the telephone company. The company has taken steps to provide new services by developing an internet service through AGLD which purchases DSL service from the telephone company and by selling billing and collecting services to

the internet and long distance companies. [citation omitted] By all indications, AGTC is a very well-run business operating in a high cost market.

AGTC IB at 31

This statement is contrary to all of the evidence adduced in this proceeding. The record reflects that AGTC was remiss in proper assignment of costs and expenses, permitting its long distance affiliate's Internet operation to "ride free" on billing services, until the Staff's investigation revealed that this was taking place. Staff Ex. 1.0 at 4-5; 2.0 at 13-16. . Moreover, if AGTC can truly use current employees to provision services that AGTC itself does not provide, it appears likely that AGTC has employed too many people over the past years, and has apparently done so to insure that the non-regulated affiliates do not need to employ anyone. This does not point to a "very well-run business"; rather, it points to a business that needs, in the worst way, to perform a complete and thorough review of its expenses to insure that all direct and indirect costs are properly assigned to its non-regulated subsidiaries. Staff Ex. 1.0 at 4-5; 2.0 at 13-18; 4.0 at 13-14. The review should use the cost allocation methodologies of 83 Ill. Adm. Code 712. Staff Ex. 2.0 at 16; 4.0 at 8 – 9.

1. Allocating Only 5% of Mr. Wilkening's salary and 5% of Board fees to non-regulated subsidiaries is unreasonably low.

As previously noted, Alhambra should not receive any IUSF funding until Alhambra performs a complete and thorough review of its expenses to insure that all direct and indirect costs are properly assigned to Alhambra's non-

regulated subsidiaries. Staff Ex. 1.0 at 4-5; 2.0 at 13-18; 4.0 at 13-14. The review should use the cost allocation methodologies of 83 Ill. Adm. Code 712. Staff Ex. 2.0 at 16; 4.0 at 8 - 9.

AGTC proposes an allocation of 5% of Mr. Wilkening's salary and 5% of the Board of Directors' expenses to Alhambra-Grantfork Long Distance, describing this as "reasonable". AGTC IB at 38. This allocation is not reasonable; rather, the 5% allocation proposed by AGTC is a mere token gesture to avoid a complete review aimed at the elimination of all subsidization by AGTC of its subsidiaries.

The record reflects that members of AGTC's Board of Directors spend a significant amount of time on the evaluation of AGTC investment in the Alhambra Cellular and the limited partnership. This fact is amply demonstrated by AGTC's assignment of expense to Alhambra Cellular in its surrebuttal testimony. This allocation reflects that three members of the Board of Directors each spent two entire working days attending meetings of the limited partnership, which were held in Schaumburg, Illinois. AGTC Ex. 5.0 at 16. These actual events should be contrasted with AGTC's claim that the Board of Directors spends "less than five minutes per month" on AGLD and Alhambra Cellular matters. AGTC Ex. 4.0 at 3-4. Since AGTC estimates that its directors devote less than one hour per year each to AGLD and Alhambra Cellular, the meetings in Schaumburg, which were devoted exclusively to the cellular operation, consumed the Board's entire allocation of time to the cellular operation for something on the order of 32 years (meetings and travel take eight hours – conservatively – per day, times two days;

the Board, according to AGTC, spends about ½ hour per year on the cellular operation). This appears inconsistent with AGTC's 5% allocation.

Since AGTC's own case is not internally consistent, giving it credence is unwise; instead, the Commission should require AGTC to perform a complete and thorough review of its expenses, using Commission-approved cost allocation methodologies.

2. AGTC has not allocated other common costs between AGTC and its non-regulated subsidiary AGLD

AGTC states that there are no costs common to AGTC and AGLD (other than those Staff discovered and AGTC was forced to acknowledge). AGTC IB at 40. Thus, posits AGTC, Staff is "speculat[ing]" regarding the existence of others, and that Staff is contending that: "what it hasn't found may exist anyway." Id. AGTC further contends that:

The argument to consolidate the revenues and expenses of AGLD with AGTC for ROR purposes is predicated on the assumption that AGLD was not paying for its expenses but AGTC made the adjustments necessary to correct those items that were overlooked. [citation omitted] Staff has allocated costs between regulated and non-regulated companies in numerous cases involving utilities many times larger than AGTC and Staff cannot legitimately throw up its hands and claim that the Commission is better off consolidating the operations of a tiny phone company and its reseller affiliate. If anything, consolidating the ROR statements for AGTC and AGLD is the worst thing that could be done, especially since the revenues and expenses of the two companies have been properly allocated. [citation omitted]

Id.

This statement ignores a number of inconvenient facts. First, AGTC's assertion that it "made the adjustments necessary to correct those items that

were overlooked[,]" ignores the fact that AGTC was the party that did the "overlooking" of these adjustments, and sought to recover these "overlooked" items in its initial ROR deficiency in this proceeding. AGTC did not properly allocate these items until Staff discovered that they were improperly allocated.

Second, it is eminently reasonable to conclude that, since Staff discovered certain costs that AGTC had misallocated (favoring, needless to say, the non-regulated affiliates), others might well exist. This is not "speculation"; rather, it is a reasonable response to AGTC's unquestionably poor cost allocation. Similarly if AGTC allocates 5% of Board of Directors' fees to AGLD, then it would be reasonable to also allocate 5% of other Board of Directors' costs to AGLD as well (e.g. costs incurred by the Board of Directors such as furniture expenditures necessary to equip the room in which the Board of Directors meets).

Staff has indeed, as AGTC suggests, "allocated costs between regulated and non-regulated companies in numerous cases involving utilities many times larger than AGTC". AGTC IB at 41. However, it is not the obligation of Staff to allocate costs between regulated and non-regulated companies; it is, in this case, AGTC's responsibility, and is a responsibility that AGTC has demonstrated itself unwilling or unable to properly carry out. It is the obligation of the regulated entity to properly assign and allocated expenses and costs. Any Staff proposed remedy is necessary in the absence of the proper assignment and allocation by the regulated entity. Staff is not, as AGTC suggests, "throw[ing] up its hands", AGTC IB at 41; it is merely pointing out that proper cost allocation does not appear to be AGTC's strong suit, and recommending a rational solution to this problem.

AGTC has made virtually no attempt to allocate any common costs, and indeed suggests that there are none (other than those discovered by the Staff). AGTC IB at 40. In addition, AGTC has been slow to respond to Staff's Data Requests concerning costs that are arguably common to AGTC and its affiliates; consequently Staff has not had the time to make detailed common cost allocations itself, which as noted above, is AGTC's – not Staff's – responsibility in any case. Accordingly, to grant AGTC's request for increased IUSF funding at this time would therefore reward inaction and delay. The Commission should, accordingly, deny AGTC's request.

G. AGTC must account for increased federal USF payments and increased interstate access revenues before submitting its request for IUSF funding

AGTC attempts to respond to the undoubted fact that it will receive considerably larger access revenues as a result of its outside plant upgrade in the following manner:

Staff argued that Alhambra will receive greater access revenues in the future [citation omitted], but this is patently incorrect. AGTC's access revenues are not going to increase, because its rates were filed on a prospective basis and already reflect the plant additions. [citation omitted] Any projections of federal funding and state and federal access changes are highly questionable beyond 2005, and may be significantly modified by the FCC in the near future [citation omitted]

AGTC IB at 41

This argument is simply not credible. The record reflects that ****XXXX

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XXXXXXXXXX.**** Staff Ex. 4.0R (Confidential), Attachments A and B. ****

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XXXX XXXXXXXXXXXXXXXX,**** Id., and this is confirmed by the testimony of SBC witness Mr. Stidham. SBC Ex. 1.0 at 5-6, 22-26. AGTC will receive greater federal support and access revenues in future, its protestation to the contrary notwithstanding.

AGTC attempts to argue that these increases in access revenues are not “known and measurable”, AGTC IB at 41, since the access charge regime “may be significantly modified by the FCC in the near future[.]” Id. This argument is not credible. AGTC is asserting that increases in its access revenues cannot be estimated because of something that “may” happen. In other words, while increases in revenues can be estimated ****XXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXX,**** Staff Ex. 4.0R (Confidential), Attachment B, some possible change to the access charge regime, which “may” occur, might reduce AGTC’s revenues, thereby rendering this change impossible to measure.⁵ It is impossible to see what *might* ever be known and measurable under AGTC’s standard.

Moreover, the fact that AGTC will unquestionably receive increased federal high cost support, as well as increased access charge revenues, is one that (a) ****XX

XXXXXXXXXXXXX,**** (b) AGTC did not see fit to apprise the Commission of this substantial increase in its income, either in its *Petition* or its subsequent case; and (c) is a showing that AGTC is required to make, inasmuch as the federal support the company receives must be shown, since the formula for IUSF

⁵ It might also, perhaps, increase such revenues, although AGTC does not mention this.

support is the difference between economic cost and affordable rate, less federal support received. AGTC, therefore, must amend its Petition for Relief to take into account increased federal USF support as well as increased interstate access revenue.

III. Conclusion

The Commission should deny AGTC's request for IUSF funding. Considerations of sound public policy, administrative economy, and treating similarly situated carriers the same require this outcome. Further, the IUSF is not intended to guarantee a rate of return.

Further, AGTC has shown no compelling rationale or credible basis for an award of IUSF support. The evidence overwhelmingly supports the proposition that AGTC's allegedly changed financial circumstances are entirely due to the company's decision to upgrade its network so that it can provision advanced services, which are not supported by the IUSF. Its assertion that the upgrade was intended to improve voice grade service and provide redundant toll capability to part of its service territory is contrary to the evidence. AGTC also fails to apprise the Commission of significant increases in federal high cost support and interstate access revenue that it will enjoy.

Finally, should the Commission reach the merits of AGTC's assertions, it should nonetheless deny the *Petition*. The overwhelming weight of evidence indicates that, when costs are properly allocated to its unregulated affiliates, and when federal funds it will realize from its plant upgrade are taken into account, AGTC is in fact earning significantly more than the target rate of return.

WHEREFORE, for all of the reasons articulated above, the Staff of the Illinois Commerce Commission hereby requests that its recommendations to the Commission be adopted.

Respectfully submitted,

/s/ _____

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